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Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: retirementincomereview@treasury.gov.au

10 February 2020

Dear Review Secretariat,

Retirement Income Review Consultation Paper

Thank you for the opportunity to provide a submission on the Consultation Paper. With a strong presence in the Australian retirement income market Colonial First State (CFS) welcomes the focus on current state of the system and its continued development to ensure improved retirement outcomes for Australians.

Colonial First State has actively participated in previous consultations (including through Commonwealth Bank submissions) relating both to superannuation adequacy, and retirement income policy settings, including the Financial System Inquiry, and recent Treasury consultations on retirement incomes. We have contributed to the FSC and ASFA submissions on this Consultation Paper, and we support those submissions. In this response we emphasise our views on certain key points which we believe are critical in developing the system to benefit members in retirement.

Colonial First State

Established in 1988, Colonial First State specifically provides investment, superannuation and retirement products to individuals and companies. CFS is the largest account based pension provider in Australia, making more pension payments than any non-government entity. CFS is also the third largest administrator of retail funds with $144 billion Funds under Administration.[1]

Key Points / Feedback on Consultation Paper

- **CFS broadly supports the current structure of the Australian retirement income system as outlined on page four of the Consultation Paper**, often referred to as comprising 'the three pillars'. The system is well advanced compared to other systems globally and is admired internationally, largely as a result of our early adoption of a compulsory defined contribution scheme. Compulsory superannuation through the Superannuation Guarantee has helped build the wealth of Australians, on average, to some of the wealthiest households in the world.[2] (ASFA)
- **Australians are aspirational and this is the foundation upon which our retirement system has been built. In other words, Australians aspire to self-sufficiency in retirement and want more than the age pension can provide.** A recent survey conducted for ASFA showed that 80 per cent of Australians want to achieve expenditure in retirement at least equivalent to the ASFA Comfortable Retirement Standard, which suggests a 65 year old couple requires an annual income in retirement of $61,786.[3]
- **Providing an adequate safety net through the age pension remains a very important aspect of the retirement income system. CFS believes, however, given the strong preference by Australians to control their own financial security, policy settings should be directed to reducing reliance on the age pension and ensuring Australians are offered the best opportunity through superannuation policy settings to self-fund their retirement.** In a compulsory contribution superannuation system where members aspire to become self-sufficient any reduction in the level of direct support through age pension funding can be seen as a marker of the success of the system as a whole.
- **The success of the superannuation system also relies on Australians maintaining confidence in its constituent parts.** Given its close interaction with the taxation system, superannuation has been the subject of many changes over recent years, often through the annual Federal Budget cycle. When these changes have made the rules more restrictive for members, negatively impacting their ability to maximise their retirement outcomes, their confidence in superannuation suffers. The frequency of changes also reduces predictability of the system, further impacting members confidence.

1 Plan For Life September 2019
2 'Strengthening Australia's Superannuation System': ASFA March 2019
3 'Community Support for Compulsory Superannuation' – ASFA May 2019

- **In recent years, policy makers and community have reasonably raised questions about the equity and sustainability of the superannuation tax concessions. Policy measures have since been successfully introduced specifically in response to these concerns, with recent changes targeting system benefits attributable to higher income earners.** CFS believes superannuation members deserve a period of stability and a commitment to no detrimental changes to the super policy settings for a period of time.
- Further, CFS supports measures which expand the superannuation system to the benefit of members. **CFS has long supported the legislated and bipartisan measure to increase the Superannuation Guarantee to 12% and we also believe policy settings in relation to voluntary contributions and income streams should remain as flexible as possible to ensure members are motivated to engage with the system and provide for their own retirement.** Contribution rules for older workers and savers, who may not have had the benefit of compulsory superannuation throughout their working life, are particularly important and would benefit from expansion.
- **The current regulatory and product settings in the drawdown phase provide appropriate flexibility for retirees.** Recent changes to reduce tax, regulatory and social security barriers to the development of new retirement income products now provide members with the appropriate options to manage longevity risk through these types of products should this be their preference.
- **CFS's experience with its own members suggests account based pensioners are adept at appropriately managing their income to match their needs over the course of their retirement. CFS believes the role of quality financial advice is important in the pre-retirement planning phase and throughout retirement.**

Member Insights

In preparation for this response, we conducted a small set of in depth conversations with members about their experience with retirement, superannuation and the retirement income framework proposed in the consultation paper. We also reviewed our existing member insights and included these in this response.

In these conversations, CFS has observed a predominately positive attitude among members towards the Superannuation system. The majority of members we spoke to saw compulsory superannuation contributions as the pillar which would make up the majority of their income during retirement. While members were unsure if they would be eligible for a government aged pension at their time of retirement, some saw this as a safety net option for lower income earners.

Although many members think highly of the system we have heard they still struggle to understand the 'rules' around superannuation and how regulation or change may impact or benefit them.

We showed members the three pillar framework (fig.1)

With regard to pillar one, members discussed the role of government as being broader than the aged pension, they saw other government initiatives as also contributing to potential cash flows. These initiatives included Medicare, discounts for seniors, tax concessions and travel concessions, all of which were seen to alleviate cash flow burden and help them to meet the additional healthcare costs which come with old age.

Adequacy

The consultation paper invites commentary on factors the Panel should consider when assessing the adequacy of the retirement income system, measures to assess the current system and its delivery, and available evidence to assess whether retirees have an adequate level of income.

CFS supports a commitment to ensure the system is providing a dignified and comfortable level of retirement income for Australians and relieving pressure on the age pension.

The ASFA Retirement Standard benchmarks the annual budget required to fund either a comfortable or modest standard of living in retirement. It is updated quarterly to reflect inflation, and provides detailed budgets of what singles and couples would need to spend to support their chosen lifestyle. The ASFA Retirement Standard shows that a couple looking to achieve a comfortable retirement needs to spend $61,786 a year ($43,787 for singles).[4]

While account balances are growing as the superannuation system matures, many retirees will have inadequate superannuation savings to fund the lifestyle they expect in retirement. ASFA projections indicate that 43% of Australians will have sufficient savings to self-fund their retirement by 2023 (compared to 22% in 2000)[5]. Whilst the ageing of the population will continue to increase public funding allocated to pension and associated costs, the effect of an increase in the Superannuation Guarantee is projected to reduce expenditure on the Age Pension over the long term.[6]

4 https://www.superannuation.asn.au/resources/retirement-standard

5 https://www.superannuation.asn.au/ArticleDocuments/359/1907-Better-Retirement-Outcomes-a-snapshot-of-account-balances-in-Australia.pdf.aspx

6 ASFA projection and consistent with modelling in the Intergeneration Report 2015

CFS believes the key to delivering sustainability and a manageable Commonwealth government retirement and ageing budget is to encourage self-funding for retirement. **We support the current legislated increase in the superannuation guarantee contribution (SGC) to 12%.** Arguably, this is the single most important policy to address Australia's retirement savings gap. This increase will enable more retirees to attain an adequate or comfortable retirement lifestyle, with more savings available to support desired consumption.

Member insight

Some members were able to identify superannuation as beneficial from a tax perspective. Their understanding of how they could interact with the system for their benefit led them to be more engaged with their superannuation and more likely to contribute. In contrast, many members we spoke to struggled to recognise the positive tax concessions of superannuation. We believe this may be a contributing factor to why some members are less engaged with their superannuation than others are.

Adequacy continues to be a greater issue for women. While the gender gap is closing, many women still lag substantially with regards to average account balances. ASFA research indicates the median balance of Australians aged between 60-64 is $154,453 for males and $122,848 for females, compared to a targeted retirement balance of $545,000 (ASFA Comfortable Retirement Standard).[7]

We welcome further initiatives and incentives to make additional contributions to super to ensure females have adequate retirement savings. Specific measures include mandating super contributions in paid parental leave, and removing the $450 per month threshold for superannuation to be paid (this will also improve the retirement savings adequacy for low-income earners and casual participants in the workforce who often hold multiple jobs).

CFS supported the changes that allowed more people claim a tax deduction on contributions, and the introduction of catch-up contributions in the 2016 federal budget that allow people with interrupted career patterns (for example due to maternity leave) the flexibility to make further contributions. We also believe system rules in relation to voluntary contributions and income streams should remain as flexible as possible to ensure members remain motivated to engage with the system.

Research conducted by the Australian Institute of Health and Welfare projects the proportion of Australians aged 65 or over to increase to 22% of the population by 2057 (from 15% in 2017)[8]. Considering the expected significant impacts of Australia's aging population on the federal budget, CFS supports changes to contribution rules to provide further flexibility and adequacy for older Australians, including removing the work test for individuals aged under 75 and permitting catch up contributions up to age 75.

We encourage the Panel to recommend further consideration of these more flexible and equitable contribution rule settings.

Equity & Sustainability

The Consultation Paper enquires into the appropriate level of public support provided by the retirement income system and whether the system is delivering fair outcomes in retirement. It also states the overall level of support should be targeted to those who need it most.[9]

Whilst no one would disagree that the system should provide an adequate safety net for those who cannot provide for their own retirement, this statement does not explain the aims of the retirement income system in its entirety. The expectation of many aspirational middle-income earning Australians is to achieve a comfortable retirement through the superannuation system. In exchange for the preservation of their funds until retirement these members expect the existing superannuation taxation rates to be maintained.

Members who save through this system reduce the level of direct public support required through age pension expenses as self-sufficiency in retirement increases. Growing household wealth at retirement, including as a result of compulsory superannuation, has resulted in a reduction in the proportion of the population receiving age pension over the past two decades. And, despite an ageing population, the proportion of individuals reliant on the age pension is expected to fall over the long term assuming the SG rate is increased to 12 per cent.[10] This is incredibly important given members' desire to be self-sufficient in retirement.

7 https://www.superannuation.asn.au/ArticleDocuments/359/1907-Better-Retirement-Outcomes-a-snapshot-of-account-balances-in-Australia.pdf.aspx

8 https://www.aihw.gov.au/reports/older-people/older-australia-at-a-glance/contents/demographics-of-older-australians/australia-s-changing-age-gender-profile

9 Page 18

10 ASFA Retirement Income Review Submission

Colonial First State

Superannuation tax is generally set at a concessional rate compared to individual marginal tax rates, and therefore, where many income earners are concerned, this comes at a cost to the federal budget. It follows that periodic assessment of the equity of government support provided through the retirement income system is important. However, in order to accurately assess these costs an acceptable measure or benchmark must be used. In recent years there has been much debate about the appropriateness of the benchmark and methodology used to 'cost' the tax concessions relating to super. As recently as October 2017 a consultation on the Tax Expenditures Statement[11] was conducted, leading to a range of submissions which addressed the limitations of the benchmark ('the income method'). To the extent the Consultation Paper uses this same benchmark it is likely to overstate the value of the tax concessions. This is because it does not take into account behavioural changes taxpayers would undertake should the tax concessions not be available. For example, it is unlikely that a taxpayer who makes discretionary contributions to superannuation would hold this money in a bank deposit account if superannuation was not taxed at concessional rates.

Therefore we believe the model often used by Treasury in the past, and likely to have been used in figure 4 (see appendix 1), exaggerates the relative benefit attaching to higher income earners and the disparity in overall level of government support provided to low and high income earners through the retirement system. Further, recent changes including the May 2016 Budget changes[12] have reduced the overall amount of tax concessions for superannuation contributions and earnings and are designed to reduce the proportion of the concessions allocated to higher income earners.

In assessing the equity of the distribution of government support to the retirement system through superannuation, individual income level is one lens that can be used. The value of member superannuation account balances is another. The existing superannuation rules use a mix of both of these inputs to assess the eligibility for certain benefits and penalties relating to contributions and tax rules. In addition to transparency in relation to the methodology used to calculate the distribution of the cost of the tax concessions it would appear to be sensible to overlay the assessment with the account balance attaching to individual percentiles. Overall, however, for an accurate assessment of the cost of tax concessions in superannuation to take place an agreed and transparent methodology for the calculation of that fiscal cost should first be resolved.

CFS' account based pension member experience

The Consultation Paper asserts that individual choices in retirement place pressure on public finances and may affect the sustainability of the system (page 23). A better question to ask might be what societal and individual benefits, including increased living standards, are created by providing superannuation members the opportunity to become self-sufficient in retirement.

In this respect CFS has observed, in data extracted from its account based pension products, member trends relating to the drawing of annual income (as required by law) which may point towards a rational response to individual and retirement income system conditions and a desire to achieve a certain level of income irrespective of account balance.

During 2018-19[13] CFS had 139,803 account based pensioners drawing annual income payments. The following can be observed from these member accounts (and outlined in the table 1 below):

- the average balance across all accounts during this year was approximately $227k
- the average annual pension payment $14,762
- 56% of members elected to take the minimum annual pension payment (e.g. 4% of account balance for those under 65). 54% of those drawing the minimum were between 65-74 years of age
- 39% elected to draw a payment of 10%+ above the minimum amount. For those members drawing 10%+ above the statutory minimum amount around 51% were 65-74. The average account balance for this category of members is $190,830.

As would be expected average balance reduces with age across the membership. The table gives an indication of the relative average balance and how this reduces with age across the two most popular annual drawdown segments.

11 In response to House of Representatives Committee on Tax and Revenue inquiry in 2017 https://treasury.gov.au/consultation/tax-expenditures

12 Including reduced contribution caps for concessional and non-concessional contributions; extra tax on contributions for higher income earners; the introduction of the $1.6m transfer balance cap; and a tighter means test for the age pension.

13 Here, CFS has included data in relation to 2018-19 although it observes the trend of all data sets referred to have not deviated for the three years prior.

	Average Account Balance		Overall
	Receiving minimum pension	**Receiving 10%+ above minimum**	
Under 65	$347,809	$241,279	$287,217
Age 65-74	$268,189	$214,501	$249,370
Age 75-79	$200,640	$118,014	$169,710
Age 80-84	$158,456	$81,249	$133,811
Age 85-89	$128,977	$57,416	$110,494
Age 90-94	$99,055	$48,834	$87,291
Overall	$249,186	$190,830	$226,895

While members will approach their drawdown patterns differently, and for each individual there are a range of personal circumstances which impact their decision-making, this data set begins to depict a rational approach to the steady dissipation of capital over life expectancy. On this view alone it would be difficult to conclude members are conserving capital for the purpose of bequests.

Average annual income payments across all ages ranged within a small band between $13,000 and $17,500 per annum (median values: $9,000 – $13,000 p.a.). Overlaying this with lump sum withdrawal data relating to these same pension members is also instructive. Overall 15% of pension members took lump sum withdrawals during 2018-19 and the average value of withdrawal was $26,743. With the exception of the category of members aged 90 or over, the highest average value of withdrawal was attributable to members aged under 65 and ages 85-89, both around $35,000. Two thirds of members taking a lump sum withdrawal were between 65-74 at an average value of around $26k. And, aside from a very small portion of elderly pension members, overall average lump sum withdrawals also ranged within a band of $25k-$36k.

On this initial high level analysis of CFS pension data we can observe consistency across average annual pension payments and additional withdrawals. The data may suggest members are generally managing their affairs to meet targeted living expenses and lifestyle needs. It is not clear whether members are also managing their pension income levels alongside age pension entitlements, although this is entirely possible for some cohorts. CFS pension members taking higher income amounts generally have lower account balances, possibly not having benefited from compulsory superannuation to any great extent over their working lives, and appear to be making the rational decision of meeting their lifestyle and living expenses whilst their superannuation balance lasts. As superannuation matures this is likely to be a shrinking category of members.

Lump sum withdrawals appear to be drawn as required to supplement income and meet expenses, especially during the early post-retirement phase when members remain active, and during older ages when health and aged care expenses may become more important.

CFS aims to continue supplementing this initial data set with qualitative member interviews to gain further insights into the retirement decision-making of its members.

Member Insights

We have found from member conversations that many members cannot clearly articulate how their needs would change throughout retirement. Some members were conscious of likely health and financial changes in retirement but most were uncertain as to how these changes would impact their retirement needs.

We believe there are opportunities to improve how the superannuation system guides and educates members through these changes in their retirement and transition to retirement.

Cohesion

CFS believes the current regulatory and product settings in the drawdown phase provide appropriate flexibility for retirees. Recent changes to reduce tax, regulatory and social security barriers to the development of new retirement income products, including deferred lifetime annuities, now provide members with the appropriate options to manage longevity risk through these types of products should this be their preference.[14]

Account based pensions continue to be popular (the main vehicle for managing super retirement savings) because they allow retirees flexibility and control over their assets to a greater extent than other income streams. Given Australians' desire for control and self-sufficiency, we believe this trend is rational and economic. Individuals who aspire to self-sufficiency take that philosophy into retirement where they may also make rational decisions to conserve capital to the extent they can, including planning around the receipt of age pension entitlements.

As discussed above CFS data shows 56% of pensioners took the minimum income amount (2019) and there is a general propensity to take ad hoc withdrawals to manage living and lifestyle expenses both in the early years of retirement and at older ages, presumably when higher expenses are present.

The Consultation Paper asks whether financial advice is needed to achieve good outcomes for individuals. CFS believes the role of quality financial advice is important in the pre-retirement phase and throughout retirement. In the accumulation phase the common objective is to maximise savings, but in retirement needs, circumstances and objectives will vary between members with some having simpler needs than others. It is important that a person's entire personal circumstances are taken into account to understand these needs and objectives.

The advice and guidance trustees can provide to members in retirement is an important part of the process of optimising member outcomes in retirement. Trustees are well positioned to provide simple, single issue advice to members post the commencement of a retirement income stream product issued by that trustee. Intra-fund advice forms a part of this landscape. However, intra-fund advice and 'no-advice' models are not appropriate for decisions such as whether to commence an income stream.

However, to ensure good member outcomes policy makers and regulators should be careful to ensure a consistent approach and level playing field is applied to the regulations which govern the delivery of advice relating to retirement. To the extent that a trustee chooses to advise a member on the commencement of a retirement income stream (under personal advice) the same requirements should naturally apply as if advice is provided by an independent financial adviser. Importantly, this may require the trustee to research other products and strategies and consider whether alternative products outside the trustee's suite of products are in the member's best interests.

Member Insights

Many non-advised members indicated they had limited understanding about how their decisions around superannuation may influence the aged pension entitlements.

The role of providing factual, practical information to members at key milestones to assist them in informed decision making around their superannuation should be considered. Along with exploring opportunities to simplify the rules around the interaction of the age pension and superannuation.

We welcome the opportunity to discuss these issues in more detail with the Panel.

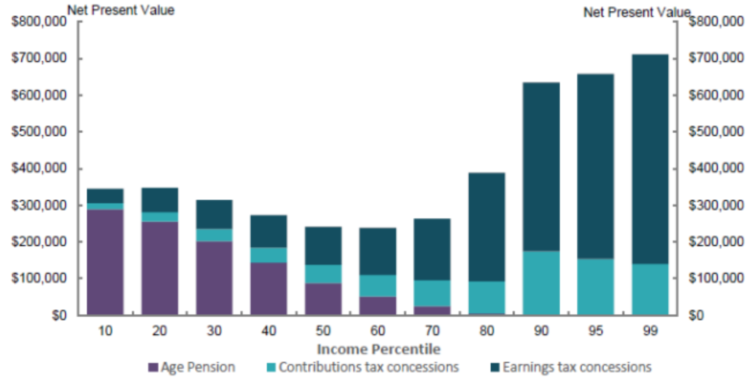
Yours sincerely,

Michael Venter
Acting Chief Operating Officer

14 Treasury Laws Amendment (2017 Measures No 1) Regulations 2017; Social Services and other Legislation Amendment (Supporting Retirement Incomes) Act 2019

Appendix 1: Retirement Income Review Consultation paper, page 18

Figure 4: Lifetime government support provided through the retirement income system[9]



Source: Treasury calculations using a hypothetical cameo model